

## Message Text

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ACTION EUR-12

INFO OCT-01 ISO-00 SP-02 USIA-15 AID-05 EB-08 NSC-05  
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R 261747Z AUG 77

FM AMEMBASSY LONDON  
TO TREASURY DEPT WASHDC  
SECSTATE WASHDC 7734  
INFO AMEMBASSY BONN  
AMEMBASSY PARIS  
AMEMBASSY ROME  
AMEMBASSY TOKYO  
AMCONSUL EDINBURGH

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DEPARTMENT PASS FEDERAL RESERVE BOARD

E.O. 11652: N/A  
TAGS: EFIN, UK  
SUBJECT: NIESR REPORT ON U.K. ECONOMIC OUTLOOK

SUMMARY: THE AUGUST APPRAISAL AND FORECAST OF THE U.K. ECONOMY BY THE NATIONAL INSTITUTE OF ECONOMIC AND SOCIAL RESEARCH (NIESR) SEES CLIMBING UNEMPLOYMENT AND REITERATE ITS SUPPORT FOR A RELATIONARY POLICY.

1. NIESR'S FORECASTS MAY BE SUMMARIZED AS

1976 1977 1978

REAL GDP

(PER CENT CHANGE YEAR/YEAR) 1.2 0.6 2.7

REAL PERSONAL DISPOSABLE INCOME

(PER CENT CHANGE YEAR/YEAR) -0.5 -2.8 4.4

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(FOURTH QUARTER, MILLION) 1.3 1.4 1.7

MONEY SUPPLY

(PER CENT CHANGE, FISCAL YEAR/

FISCAL YEAR) 9.8 12.8 13.0

CONSUMER PRICES

(PER CENT CHANGE YEAR/YEAR) 15.2 15.0 10.6

CURRENT ACCOUNT BALANCE

(YEAR, BILLION POUNDS) -1.5 0.2 2.1

PUBLIC SECTOR REQUIREMENT

(FISCAL YEAR, BILLION POUNDS) 8.8 7.0 7.5

2. THIS REVIEW NOTES THAT SEVERAL POLICIES HAVE BEEN SHIFTED IN THE TIME SINCE THEIR MAY FORECAST. (SEE LONDON 9274) IN PARTICULAR, A FORMAL INCOMES POLICY HAS BEEN ABANDONED. NIESR FEELS THAT THE GOVERNMENT WILL NEVER THELESS CONSTRAIN PUBLIC SECTOR AVERAGE EARNINGS TO A 1 PER CENT INCREASE OVER THE NEXT YEAR, AND THAT AVERAGE EARNINGS WILL GROW AT 17 PER CENT FOR THE ECONOMY AS A WHOLE. THE SECOND POLICY SHIFT HAS BEEN THE POTENTIAL INDEXATION OF PERSONAL TAX ALLOWANCES WHICH WOULD STIMULATE ECONOMIC ACTIVITY RELATIVE TO NIESR'S PREVIOUS ASSUMPTIONS.

3. THE SHARPEST CHANGES FROM THE MAY TO THE AUGUST FORECAST ARE IN DISPOSABLE INCOME AND THE CURRENT ACCOUNT FOR 1978. THE ESTIMATE FOR 1978 GROWTH IN PERSONAL DISPOSABLE INCOME WAS RAISED FROM 1.9 TO 4.4 PER CENT ON THE BASIS OF THE CHANGE IN INCOMES POLICY, CHANGES IN THE GOVERNMENT TAX POLICY, AND THE DECELERATION OF IMPORT PRICES. THE ESTIMATED CURRENT ACCOUNT BALANCE FOR 1978 HAS BEEN INCREASED TO 2.1 BILLION POUNDS FROM MAY'S 1.3 BILLION POUND ESTIMATE (ALTHOUGH 1977'S ESTIMATED SURPLUS WAS LOWERED FROM 0.4 BILLION POUNDS TO 0.2 BILLION POUNDS).

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UNDS.) THE 1978 CHANGE ARISES IN THE MAIN FROM A 2.2 BILLION POUND INCREASE IN THE ESTIMATED VALUE OF EXPORTS. THIS IS

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ATTRIBUTABLE TO A REVISED OUTLOOK FOR THE TERMS OF TRADE (EXCLUDING OIL EFFECTS) WHICH ARE NOW EXPECTED TO INCREASE BY ONE PER CENT IN 1977 AND 4 PER CENT IN 1978.

4. THE FORECAST FOR REAL GDP GROWTH HAS BEEN REVISED LE DRAMATICALLY, HAVING BEEN SET AT 1.5 PER CENT FOR 1977 AND 2.3 PER CENT IN 1978 IN THE PREVIOUS MAY FORECAST. THE INCREASED GROWTH FOR 1978 REFLECTS IN THE MAIN THE DOWNWARD REVISION OF THE 1977 ESTIMATE. IN FACT THE ESTIMATE OF THE GROWTH IN THE VOLUME OF MANUFACTURING INVESTMENT HAS BEEN REVISED DOWNWARD TO 5 PER CENT FOR 1977 AND 10 PER CENT FOR 1978 FROM THE MAY ESTIMATE OF 15 PER CENT FOR 1977 AND 12 PER CENT FOR 1978. THIS SHARP REVISION REFLECTS A HEAVIER WEIGHTING OF ECONOMETRIC FORECASTS OF INVESTMENT LEVELS AND LIGHTER WEIGHTING OF INVESTMENT INTENTION SURVEYS. (COMPARE THE TECHNICAL UNCLASSIFIED

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APPENDIX OF LONDON 12122.)

5. IN THE MAY REVIEW IT WAS ARGUED THAT A WAGE EXPLOSION IN WHICH AVERAGE EARNINGS INCREASED BY 20 PER CENT IN THE SPRING OF 1978 AND 25 PER CENT IN THE AUTUMN WOULD UNDERMINE ECONOMIC GROWTH PROSPECTS. IN PARTICULAR GDP WAS FORECAST TO FALL BY 1/2 PER CENT IN THE YEAR END IN THE FIRST HALF OF 1979 IN THE FACE OF SUCH WAGE MOVE MENTS. NO ATTEMPT IS MADE TO RECONCILE THESE ESTIMATES WITH THE CURRENT ESTIMATES.

6. IN THE APPRAISAL, NIESR EXPRESSES CONCERN THAT THE FOREIGN EXCHANGE EARNINGS OF NORTH SEA OIL EXPORTS WILL MARK A PROGRESSIVE DECLINE OF U.K. MANUFACTURING INDUSTRY UNLESS THE EXCHANGE RATE IS MANAGED TO PRESERVE COMPETITIVENESS. IT IS SUGGESTED THAT THE HIGH LEVEL

OF RESERVES LIKELY TO ACCUMULATE, SHOULD SUCH AN EX-  
CHANGE RATE POLICY BE FOLLOWED, PROVIDE GOOD GROUNDS TO  
REPAY SOME OF THE U.K.'S ACCUMULATED FOREIGN DEBT.

7. NIESR CONTINUES TO ARGUE THAT THE PSBR TARGETS ARE EXACERBATING THE U.K. RECESSION. IT NOTES THAT ITS DEFINITION OF A HIGH EMPLOYMENT BUDGET IS FORECAST TO MOVE INTO SURPLUS OVER THE FORECAST PERIOD. IT IS ARGUED FURTHER THAT AT CURRENT LOW LEVELS OF AGGREGATE DEMAND REFLATIONARY MEASURES ARE NOT LIKELY TO AFFECT THE RATES OF INFLATION.

8. THE APPRAISAL CALLS FOR A BUDGETARY POLICY WHICH WOULD RAISE 1978 GROWTH "PRUDENTLY" TO 3-1/4-4 PER CENT. THIS WOULD ACKNOWLEDGEDLY MEAN THAT THE IMF CONDITIONS WOULD PROBABLY BE BREACHED. NIESR CONCLUDES HOWEVER THAT "THE EMERGING CURRENT ACCOUNT SURPLUS ELIMINATES THE

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NEED FOR ANY FURTHER BORROWING FROM THE IMF, THE RESERVES WOULD ALREADY PERMIT THE REPAYMENT OF THE OUTSTANDING IMF DEBT, AND THE EXCHANGE POLICY OUTLINED ABOVE WOULD ACTUALLY MAKE DEBT REPAYMENT DESIRABLE." THIS CONCLUSION IS SOMEWHAT STRONGER THAN THE MAY SUGGESTION THAT THE IMF CONDITIONS BE SIMPLY RENEGOTIATED.

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